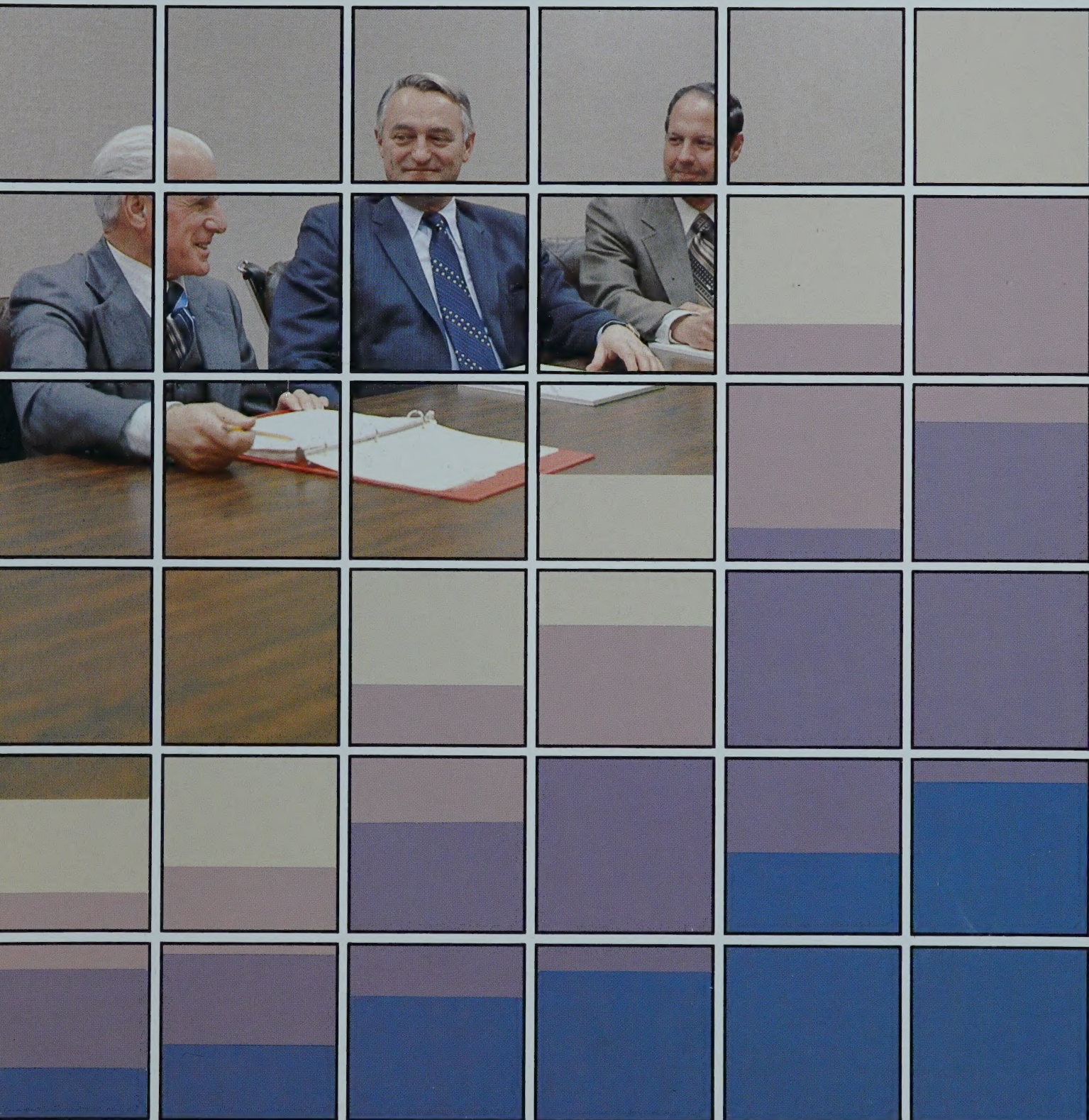


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REICHHOLD

Reichhold Limited/Limitée

1978 ANNUAL REPORT
RAPPORT ANNUEL 1978



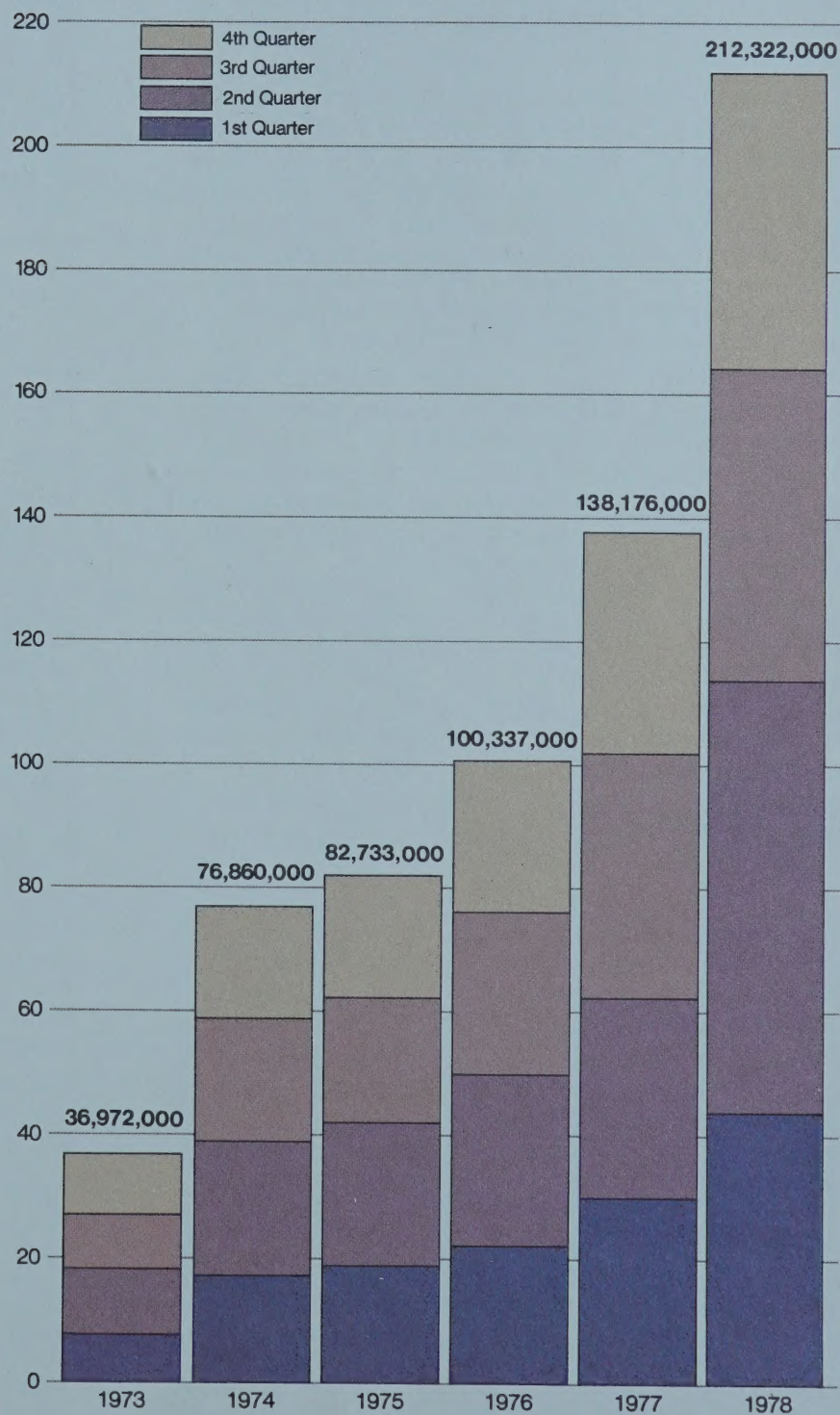
Our Year at a Glance

(Thousands of dollars except per share items.)

	1978	1977
Sales	\$ 212,322	\$ 138,176
Net earnings	5,101	2,222
Basic earnings per common share	\$ 2.53	\$ 1.39
Book value per common share	\$ 11.81	\$ 10.27

See notes at foot of 10 year financial review on page 18

REICHHOLD Consolidated Sales by Quarter



Rapport du président aux actionnaires

L'année 1978 a été pour Reichhold Limited un succès remarquable. Les principaux objectifs établis pour l'année ont été dépassés et les ventes et les bénéfices ont atteint des niveaux records pour chaque période trimestrielle.

Les ventes de 1978 au montant de \$212 millions sont supérieures de 54% à celles réalisées l'année précédente, c'est-à-dire \$138 millions. Le bénéfice net de \$5,101,000 a plus que doublé celui de \$2,222,000 pour 1977.

Cette excellente amélioration a permis au Conseil d'administration d'annoncer au cours de l'année une augmentation de 11% du taux du dividende trimestriel, soit 10 cents par action. C'est la septième année successive qu'une augmentation du dividende est accordée aux actionnaires.

Le bénéfice net de 1978 est égal à \$2.53 par action ordinaire après paiement des dividendes sur les actions privilégiées.

Les ventes de résines synthétiques ont augmenté de plus de 20% et sont particulièrement marquées dans l'industrie des produits forestiers. Une meilleure utilisation des aménagements de l'usine a entraîné une amélioration substantielle des marges de profits. La division des résines a des programmes d'agrandissement en cours aux usines de North Bay et Thunder Bay en Ontario, qui desservent l'industrie des produits forestiers. Ailleurs, les aménagements pour la production de polyester et de résine alkyde sont aussi en cours d'agrandissement.

Nos entreprises dans le domaine des arts graphiques, comprenant les divisions de Sears et de Canada Printing Ink ont eu aussi une année remarquable.

Sears domine à la distribution de machinerie et de fournitures pour les arts graphiques, et a ajouté de nouveaux assortiments d'équipement spécialisé. En 1978, des droits de distribution furent obtenus au Canada pour l'équipement d'imprimerie fabriqué par MBO et Olivetti.

Canada Printing Ink a construit l'usine d'encre d'imprimerie la plus perfectionnée du Canada, à Burlington, Ontario. Cette usine dessert les marchés des journaux et d'impressions offset en continu. Une technologie avancée et de nouveaux produits ouvrent des marchés à l'extérieur du Canada, un domaine d'opportunités qui réserve des possibilités considérables.

Les nouveaux produits sont mis au point surtout en fonction de l'économie de l'énergie, un problème mondial. Les matières premières chimiques pour la fabrication de matériaux d'isolation pourraient bien être le domaine des

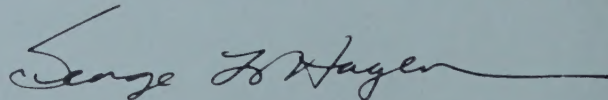
affaires qui se développera le plus considérablement au cours du prochain programme quinquennal d'expansion. Reichhold augmente sa capacité de production d'uréthane, de résines phénoliques et uréiques pour les produits d'isolation en mousse.

Le secteur des produits chimiques agricoles de Reichhold, créé par l'acquisition de Niagara Chemical au Canada et de Woolfolk Chemical aux Etats-Unis a remporté un succès appréciable pendant la période initiale de douze mois complets. Les ventes, dépassant \$56 millions, constituent une part très importante des affaires totales de Reichhold.

Les ventes de produits chimiques pour l'industrie du pétrole et du gaz ont augmenté substantiellement en 1978. Intertech, l'organe de distribution des plastiques renforcés a eu aussi une année très satisfaisante, la première année complète en tant qu'aménagement de distribution nationale de Reichhold.

Les perspectives sont excellentes pour Reichhold puisque la compagnie s'efforce d'agrandir davantage sa base actuelle déjà très importante. Nous croyons que le climat des affaires au Canada et aux Etats-Unis, du moins les secteurs qui concernent nos affaires, nous sera favorable en 1979. Un programme de longue portée mis à jour pour l'expansion de nos affaires a été conçu pour guider nos efforts. Ce projet combine les deux programmes pour l'expansion interne dans toutes les divisions avec des efforts continus d'expansion par la voie d'acquisition lorsque les nouvelles tentatives sont en harmonie avec nos ressources et nos compétences actuelles. Le prochain objectif important de la compagnie sera de réaliser des ventes annuelles profitables d'un demi-milliard en cinq ans, avec \$ 250 millions en 1979 et des profits sensiblement plus élevés que ceux de 1978. La façon dont Reichhold élabore et contrôle son programme d'expansion est expliqué ailleurs dans ce rapport. Nous nous efforcerons de maintenir un excellent rendement du capital actions et de l'ensemble des fonds consacrés à notre entreprise.

Au nom du Conseil d'administration, je désire exprimer l'appréciation pour les excellents efforts de tous les employés et pour l'appui constant de nos actionnaires.



George L. Hagen
Le président et chef de la direction,

President's message to shareholders



For Reichhold Limited, 1978 was a year of outstanding achievement. The major goals set for the year were exceeded, with record sales and earnings established for each quarterly period.

1978 sales of \$212 million are 54% ahead of the \$138 million for the previous year. Net earnings of \$5,101,000 are more than double the net earnings of \$2,222,000 for 1977.

This excellent growth permitted the Board of Directors to announce, during the year, an 11% increase in the quarterly dividend rate, to 10 cents a share. This is the seventh successive year of increase in dividends to shareholders.

1978 net earnings equalled \$2.53 per common share after payment of preferred share dividends.

Sale of synthetic resins rose over 20%, and were particularly strong in the forest products industry. Better use of plant facilities resulted in a substantial improvement of profit margins. The resin division has expansion programs underway at the North Bay and Thunder Bay, Ontario plants which serve the forest industry. Elsewhere, polyester and alkyd resin production facilities are also being expanded.

Our graphic arts business, composed of the Sears and Canada Printing Ink divisions, had an outstanding year.

Sears is the leader in distribution of graphic arts machinery and supplies, and has added new lines of specialized equipment. In 1978, distribution rights were obtained for Canada of printers' equipment manufactured by MBO and Olivetti.

Canada Printing Ink has built the most technically-advanced printing ink plant in Canada at Burlington, Ontario. This plant serves the newsprint and web offset markets. Advanced technology and new products are opening markets outside Canada, an area of opportunity which holds considerable potential.

New products are being developed, especially related to the world's energy concerns. The chemical raw materials for manufacturing insulating materials may prove to be the most dynamically growing business area through the next five-year growth plan. Reichhold is increasing its capacity to produce urethane, phenol and urea resins for foamed insulation products.

The agricultural chemicals business created by the acquisition of Niagara Chemical in Canada and Woolfolk Chemical in the United States had a successful initial full twelve month period as part of Reichhold. Sales of over \$56 million were achieved, making this a very important part of Reichhold's total business.

Sales of chemicals for the oil and gas industry rose substantially in 1978. The Intertech reinforced plastics distribution business had a very satisfactory year, its first full year as a nationwide Reichhold distribution facility.

The outlook for Reichhold is excellent as the Company strives to grow further from its present very substantial base. We believe that the business climate in both Canada and the United States, at least the parts that affect our business, will be good in 1979. An updated long-range plan for growth has been developed as a guide for our efforts. This combines both plans for internal growth in all divisions, with continuing efforts to expand through acquisition where new ventures fit in with existing resources and capabilities.

The Company's next major goal is to achieve profitable annual sales of a half-billion dollars in five years; with 1979 reaching \$250 million and profits substantially ahead of 1978. How Reichhold plans and controls its growth programs is discussed elsewhere in this report. Our emphasis will be on continuing to achieve an excellent return on equity and on total capital employed in the business.

On behalf of the Board of Directors, I express appreciation for the excellent efforts of all employees and the continuing support of our shareholders.

George L. Hagen
President and Chief Executive Officer

REICHHOLD





Growth through planning



The planning process is the principal tool of corporate management. At Reichhold, planning both short-range and for the longer-term is the key to unlocking growth.

Reichhold's growth record of the last ten years has been accomplished according to carefully determined plans and objectives set by management.

These objectives were to create an organization which would have the financial, business and human resources to successfully compete in Canada, and internationally.

Reichhold has changed from a relatively modest-sized producer of resins to an important force in three broad areas of business — resins for a wide variety of industries including the paint and forest product industries, products for the printing and graphic arts industries and agricultural chemicals to protect crops.

This new business mix reflects the goal of building a broad sales base as a larger foundation for another extended period of growth in both sales and profitability.

Diversification reduced the vulnerability of a single product line organization to any sudden declines in those products. Growth through acquisition provided the opportunity to enter new fields with good potential for the future.

New businesses were encouraged to expand their organizations by a policy of autonomy supported by the total resources of the company; they have all grown substantially since acquisition.

Reichhold's planning techniques follow the procedures of modern business — the one year projection and the five-year long-range plan. These are based on general economic conditions, close relationship with customers and the knowledge and perceptions of everyone concerned in their special areas of activity.

All departments contribute to the determination of growth targets and work together toward the successful execution of the plan.

A review of previous plans show that it works well at Reichhold. A sales target of \$55 million set in 1970 for 1974 was surpassed with ease. The \$130 million planned for 1977 and the \$205 million planned for 1978 were also met due to diligent planning.

The company's growth in the last 20 years from \$6 million in sales is remarkable but its structured planned growth in the last ten years has been extraordinary. Sales have increased tenfold, but more important after tax earnings were 23 times higher in 1978 than in 1969.

The latest sales target, a half-billion dollars, carries many implications. This growth will allow, profits and dividends to increase. Inherent in a larger organization are efficiencies of scale which result in improved profit margins.

Company policy is to increase dividends as earnings rise. This is reflected in seven successive years of higher dividends, as dividends climbed from 8 cents a share to 38 cents.

The book value per common share has increased steadily from 1968 at \$2.95 a share to \$11.81 at the end of 1978. Significantly, the rate of growth in net worth of companies acquired is greater than growth in the overall figure. Canada Printing Ink, the first acquisition made in 1968, has almost quadrupled in net worth. Sears net worth tripled in the first four years after acquisition.

The present strategic plan has been formulated by analysis of the likely direction of the world economy, the directions of individual industries and Reichhold's own strengths and abilities.

Reichhold has established itself in the United States through its agricultural chemicals business. A major concern of the United States, indeed, of the rest of the world, is energy as well as food. The Company has already taken steps to determine potential opportunities in energy and food or agri-business industries in the United States and Canada.

Through the Travis Chemicals division a foothold has been established in the western Canadian oil and gas industries. More effort will be made to establish new business related to these vital industries.

The forest products industry offers potential for further penetration of Reichhold resins. Energy conservation also offers opportunities for Reichhold insulation resins.

The printing and graphic arts industries have been undergoing revolutions in technology. Growth is expected to be at a rate much greater than the national economy. Already the largest supplier in Canada, Reichhold's Sears and Canada Printing Ink divisions are in excellent position with expanding capacity and new equipment.

Planning for growth means determining where opportunities exist and pursuing them with all the resources and skills available. Reichhold has been following such policies through a decade of achievement. The target of the management team is to improve on past achievements.

Growth with financial control



A system of financial control is vital in both the planning and execution of growth programs.

Today, a combination of high-speed computers and the knowledge and creativity of financial specialists permits Reichhold to maintain the kind of close control on all facets of the Corporation's activities required to achieve targets.

Financial planning concentrates on building existing activities and preparing for new opportunities as they are identified, pursued and subsequently acquired. Reichhold financial expertise is applied to new acquisitions.

Financial planners and senior management strive to maintain the financial flexibility of the Company so that new opportunities can be seized as they arise. They are concerned with conditions in world financial markets and relationships with bankers and investment houses who assist corporations in raising large amounts of capital for major acquisitions and capital expansions.

A main element in the growth plan of the past decade was the broadening of share ownership and the establishment of access to investment markets.

That these efforts have been successful was proven when \$20 million of new financing was obtained in 1976-77 to underpin the growth already achieved and to lay a base for the future.

Reichhold has excellent relationships with several banks in Canada and the U.S. and the guidance of a major Canadian investment firm. These financial institutions have an intimate knowledge of the Company's activities and its long-range objectives.

These relationships are part of the broad plan that balances almost equally growth in present activities with growth in new projects — acquisitions, diversifications, major new products.

Developing and monitoring internal growth objectives is a continuing watch on developments.

Each Reichhold division prepares a detailed annual plan, establishing how the year ahead will fit into five-year targets. At the same time, the targets for each of the five years ahead are revised annually as new developments indicate.

Reichhold's administrative financial specialists follow and analyze both plans and performance, reporting continuously to division managers and the senior management team. This system of financial information alerts managers to both pitfalls and opportunities.

Currently, special emphasis continues to be placed on improving profit margins and return on investment — in effect, working more efficiently with the now very much larger Reichhold business base. Close financial control and the alert system inherent in the frequent financial analyses carried already show results. In 1978, operating profit on sales was 5.7% a significant improvement from 4.4% in 1977. Return on shareholders' equity improved to 17.7% from 10.4% in 1977.

It is the long range objective of the company to keep this ratio above the industry average.

Reichhold Limited

Consolidated Statement of Earnings

Year ended December 31, 1978 with comparative figures for 1977 (thousands of dollars except for per share items)

	1978	1977
Sales (note 4)	\$ 212,322	138,176
Cost of goods sold	167,427	108,602
Gross profit	44,895	29,574
Selling, general and administrative expenses	32,763	23,475
Operating profit	12,132	6,099
Interest expense (net) (note 5)	3,094	2,132
Earnings before income taxes	9,038	3,967
Income taxes:		
Current	1,303	807
Deferred	2,634	938
	3,937	1,745
Net earnings	\$ 5,101	2,222
Basic earnings per share	\$ 2.53	1.39
(Fully diluted earnings per share for 1978 — \$1.60 (note 6(b)))		
The statement of earnings includes the following charges:		
Depreciation and amortization of property, plant and equipment	\$ 2,310	1,942
Amortization of deferred charges	32	31
Amortization of goodwill	97	90
Directors' and senior officers' remuneration	686	581

See accompanying notes to consolidated financial statements.

Reichhold Limited

(Incorporated under the laws of the Province of Ontario, Canada)

Consolidated Balance Sheet

December 31, 1978 with comparative figures for 1977 (thousands of dollars)

Assets	1978	1977
Current assets:		
Cash	\$ 207	1,641
Receivables, net of allowance for doubtful accounts	37,431	28,669
Lien notes receivable (note 7)	6,036	5,934
Inventories:		
Raw materials	7,976	5,805
Finished goods	34,437	22,302
Total inventories	42,413	28,107
Prepaid expenses and deposits	1,951	1,250
Total current assets	88,038	65,601
Property, plant and equipment:		
Buildings	9,368	8,209
Equipment and leasehold improvements	29,604	24,440
	38,972	32,649
Less accumulated depreciation and amortization	15,226	12,997
	23,746	19,652
Land	1,923	827
Net property, plant and equipment	25,669	20,479
Other assets, at cost less amortization:		
Goodwill	699	381
Deferred charges	385	417
	1,084	798
	\$ 114,791	86,878

See accompanying notes to consolidated financial statements.

Liabilities and Shareholders' Equity	1978	1977
Current liabilities:		
Bank advances and acceptances, secured (note 8)	\$ 39,439	23,311
Accounts payable and accrued expenses	24,133	17,690
Income taxes payable	44	454
Current portion of long term debt (note 9)	220	220
Current portion of deferred income taxes	993	792
Total current liabilities	64,829	42,467
Long term debt (note 9)	12,900	13,620
Deferred income taxes	6,263	3,831
Shareholders' equity		
Capital stock (note 6):		
Preference shares:		
Authorized 3,000,000 preference shares with a par value of \$10 each; issued 784,750		
7 1/4% cumulative redeemable convertible preference shares, Series A,		
(1977 — 1,000,000 shares)	7,847	10,000
Common shares:		
Authorized 6,862,500 shares without par value; issued 1,910,390 shares		
(1977 — 1,602,747 shares)	3,507	1,257
Contributed surplus	1,436	1,436
Retained earnings (note 6(c))	18,009	14,267
Total shareholders' equity	30,799	26,960
Commitments (note 10)		
	\$ 114,791	86,878

On behalf of the Board:

Director D.G. McNABB

Director G.L. HAGEN

Reichhold Limited

Consolidated Statement of Changes in Financial Position

Year ended December 31, 1978 with comparative figures for 1977 (thousands of dollars)

	1978	1977
Additions to working capital:		
Net earnings	\$ 5,101	2,222
Add charges not requiring an outlay of funds:		
Depreciation and amortization	2,439	2,063
Deferred income taxes (non-current)	2,432	938
Additions to working capital from operations	9,972	5,223
Shares issued (note 6(b))	97	10,033
Long term debt issued	—	7,000
Proceeds on sale of fixed assets	83	257
Total additions to working capital	10,152	22,513
Deductions from working capital:		
Acquisition of subsidiary company (note 3)	—	6,435
Less working capital acquired	—	5,520
Net acquisition	—	915
Additions to property, plant and equipment	7,583	3,654
Additions to goodwill	415	—
Additions to deferred charges	—	66
Dividends	1,359	544
Reduction in long term debt	720	7,506
Share issue costs net of related current income tax effect of \$61	—	479
Total deductions from working capital	10,077	13,164
Increase in working capital	75	9,349
Working capital, beginning of year	23,134	13,785
Working capital, end of year	\$ 23,209	23,134

See accompanying notes to consolidated financial statements.

Reichhold Limited

Consolidated Statement of Retained Earnings

Year ended December 31, 1978 with comparative figures for 1977 (thousands of dollars)

	1978	1977
Retained earnings, beginning of year:		
As previously reported	\$ 13,975	12,981
Adjustment of prior year for retroactive change in inventory valuation of a subsidiary (note 2)	292	—
As restated	14,267	12,981
Net earnings for the year	5,101	2,222
	19,368	15,203
Deduct:		
Issue cost of preference shares, net of income tax effect	—	392
Dividends	1,359	544
	1,359	936
Retained earnings, end of year (note 6(c))	\$ 18,009	14,267

See accompanying notes to consolidated financial statements.

Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Reichhold Limited as at December 31, 1978 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination of Reichhold Limited and those subsidiaries of which we are the auditors was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances. We have relied on the reports of the auditors who have examined the financial statements of the United States subsidiaries.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied, after giving retroactive effect to the changes in accounting policies (with which we concur) as referred to in note 2 to the consolidated financial statements, on a basis consistent with that of the preceding year.

Toronto, Canada
February 26, 1979

PEAT, MARWICK, MITCHELL & CO.
Chartered Accountants

Reichhold Limited

Notes to Consolidated Financial Statements

December 31, 1978

1. Summary of significant accounting policies:

- (a) Basis of consolidation:
The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly-owned. All material inter-company items have been eliminated.
- (b) Lien notes receivable:
In accordance with generally recognized trade practice, lien notes receivable which include amounts due after one year, are included in current assets.
- (c) Inventories:
Inventories are stated at the lower of cost and replacement cost for raw materials and at the lower of cost and net realizable value for finished goods except for chemical manufactured goods which are generally at the lowest of cost, reproduction cost and net realizable value.
- (d) Property, plant and equipment:
Property, plant and equipment are carried at cost. On retirement or disposal of such assets, the cost thereof and related accumulated depreciation are eliminated from the accounts and any resultant gain or loss is included in income.

Depreciation of buildings and equipment is based on the estimated useful lives of the assets, calculated on the straight-line and diminishing balance methods. The principal categories and amortization periods or rates are as follows:

Buildings	5% diminishing balance
Machinery and equipment	5 to 15 years straight-line
Automobiles	30% diminishing balance
Leasehold improvements	straight-line over the respective terms of the leases

- (e) Goodwill:
Goodwill, being the excess of the cost of subsidiaries and businesses acquired over the value of their underlying net assets at the dates of acquisition, is being amortized to earnings on the straight-line method over varying periods ranging from 5 to 10 years.
- (f) Income taxes:
Investment tax credits are treated as a reduction of the carrying value of the related assets.
- (g) Research and development costs:
Research and development costs relating to both future and present products are charged against income as incurred.
- (h) Foreign currency translation:
Assets, liabilities, revenue and expenses of foreign subsidiaries are translated into Canadian dollars at the exchange rates prevailing at the end of the year. Transactions in foreign currencies are recorded at the Canadian dollar equivalent at the time of the transactions. Foreign currency gains or losses were not significant.

2. Changes in accounting policies:

- (a) As stated in note 1(b) to the 1977 annual financial statements the United States operating subsidiary uses the last-in, first-out (LIFO) method in determining the cost of inventory; however, as at December 31, 1978, for consolidation purposes only, cost of inventory of that subsidiary has been determined on the first-in, first-out (FIFO) basis to be consistent with the accounting policy generally followed by the company. This change was applied retroactively to August 1, 1977, the date of acquisition of the subsidiary and has the effect of increasing net earnings for 1978 and 1977 by \$548,000 (\$0.32 per share) and \$292,000 (\$0.18 per share) respectively. The 1977 accounts have been restated accordingly.
- (b) Consistent with the policy noted above (note 1(b)), comparative figures have been restated to show lien notes receivable as current assets.

3. Acquisition:

The Company acquired all of the outstanding shares of Woolfolk Chemical Works, Inc. Fort Valley, Georgia on August 1, 1977. Woolfolk formulates and distributes a broad line of agricultural chemicals. The consolidated statement of earnings of the Company includes the results of operations of the acquired company from the date of acquisition. Details of such acquisition which was accounted for by the purchase method, are as follows:

	(thousands of dollars)	
Net assets acquired, at fair values:		
Current assets	\$	20,984
Current liabilities		<u>15,464</u>
Working capital		5,520
Property, plant and equipment		<u>915</u>
	\$	<u>6,435</u>
Cash paid	\$	<u><u>6,435</u></u>

4. Sales by principal classes of operations:

	1978	1977
	(thousands of dollars)	
Printing inks, graphic arts equipment and supplies	\$ 60,028	49,550
Resins and industrial chemicals	78,332	64,177
Agricultural chemicals	56,456	8,758
Oil and gas chemicals and other	17,506	15,691
	<u><u>\$212,322</u></u>	<u><u>138,176</u></u>

5. Interest

Interest expense (net) is comprised as follows:

	1978	1977
	(thousands of dollars)	
Interest on long term debt	\$ 1,383	1,551
Bank and other	<u>3,641</u>	<u>1,849</u>
	5,024	3,400
Deduct interest income	<u>1,930</u>	<u>1,268</u>
Interest expense (net)	<u><u>\$ 3,094</u></u>	<u><u>2,132</u></u>

6. Capital stock:

- (a) The Series A preference shares are convertible at any time up to December 8, 1982 at the option of the holder into common shares of the Company at a conversion price of \$7.60 per common share, and are redeemable at the option of the Company after that date at \$10.50 per share if redeemed on or before December 8, 1983 decreasing to \$10.00 per share if redeemed after December 8, 1987.
- (b) In connection with the issue of the 8 1/2% sinking fund debentures, Series A, warrants are outstanding exercisable to November 1, 1979 entitling the holders thereof to purchase 266,475 common shares at a price of \$4.00 per share.

The Company has a stock option plan under which options may be granted to key employees of the Company and its subsidiaries to purchase common shares at prices to be not less than the market value as determined by trading on The Toronto Stock Exchange on the day each option is granted. No options were granted or exercised during the year. At December 31, 1978 options were outstanding covering 6,000 shares at \$5.96 exercisable to October 23, 1980 and 6,000 shares at \$6.92 exercisable to April 25, 1982.

Notes to Consolidated Financial Statements (continued)

During the year common shares were issued as follows:

	Number of common shares issued	Price	Total
Conversion of 215,250 preference shares	283,193	\$ 7.60	\$2,152,267
Exercise of warrants	24,450	4.00	97,800
	<u>307,643</u>		<u>\$2,250,067</u>

The Company has reserved 1,329,040 common shares for the potential conversion of the Series A preference shares, exercise of the warrants and the stock option plan, as described above. Exercise of the preference share conversion privileges, share purchase warrants and options would result in dilution of earnings per common share as disclosed in the consolidated statement of earnings.

- (c) The Series A preference shares and the debt instruments referred to in note 9, provide certain restrictions on the payment of dividends on common shares. Under the most restrictive of these provisions \$13,819,000 of consolidated retained earnings at December 31, 1978 were available for the payment of dividends to the holders of common shares. The debt instruments do not prevent the Company from paying fixed cumulative cash dividends on its preference shares.

7. Lien notes receivable:

Lien notes receivable consist of the following:

	1978 (thousands of dollars)	1977
Gross amounts receivable	\$ 8,419	8,302
Less unearned interest	<u>2,383</u>	<u>2,368</u>
	<u>\$ 6,036</u>	<u>5,934</u>
Amounts due after one year	<u>\$ 4,896</u>	<u>4,213</u>

8. Bank advances and acceptances:

Bank advances and acceptances are secured by assignments of receivables and by pledges of inventories.

9. Long term debt:

Long term debt consists of the following:

	1978 (thousands of dollars)	1977
Sinking fund debentures:		
8 1/2% Series A, due November 1, 1989 (retractable November 1, 1979)	\$ 3,120	3,340
11 1/4% Series B, due February 15, 1996 (retractable February 15, 1986)	7,000	7,000
10 5/8% secured sinking fund bond Series A, due April 1, 1992	3,000	3,000
Bank term loan	<u>—</u>	<u>500</u>
	<u>13,120</u>	<u>13,840</u>
Less current portion	<u>220</u>	<u>220</u>
	<u>\$12,900</u>	<u>13,620</u>

(a) Sinking fund debentures:

The debentures are secured by a first floating charge on all the assets of the Company, except for receivables assigned and inventories pledged to secure bank advances and acceptances (note 8).

The Company is required to establish sinking funds sufficient to retire, in the case of the Series A debentures, \$220,000 principal amount annually through November 1979, and thereafter, equal annual payments reducing the principal amount outstanding to \$800,000 by November 1, 1988, and in the case of the Series B debentures, 8.5% annually of the principal amount outstanding on February 16, 1986, commencing in 1987 and continuing through 1995.

The Company may, if certain conditions are met, including payment of premiums, redeem the debentures. The debentures are repayable at the holders' option on November 1, 1979 with respect to the Series A and on February 15, 1986 with respect to the Series B. During 1978, Series A debentures in the principal amount of \$220,000 were purchased and applied against 1978 sinking fund requirements.

(b) 10 5/8% secured sinking fund bond, Series A, due April 1, 1992:

The bond is secured by a first fixed charge on the Thunder Bay property. In addition, the bond is secured by a floating charge on all other assets of the Company, subject to certain other rights and exceptions and the floating charge created to secure the Company's sinking fund debentures.

The Company is required to establish a sinking fund to retire principal amounts of \$100,000 annually commencing in 1981, rising to \$400,000 annually in 1990, with the balance of \$400,000 payable in 1992.

(c) Summary of repayment requirements:

Payments required to meet sinking fund requirements and other debt retirement provisions during the five years ending December 31, 1983 are as follows: 1979 — \$220,000; 1980 — \$233,000; 1981 — \$333,000; 1982 — \$334,000 and 1983 — \$433,000.

In addition, amounts may be required on November 1, 1979 to repay any Series A debentures tendered under the retractable provisions.

10. Commitments:

Annual rentals on leased premises amounted to \$938,000 at December 31, 1978; leases extend to various dates to 1988. Approved expenditures for plant and equipment additions at December 31, 1978 amounted to \$2,350,000.

11. Pension plans:

The Company maintains pension plans which cover substantially all of its employees. In 1978 an actuarial valuation as at December 31, 1977 indicated that the present value of unfunded liabilities of the plan was \$200,000. Of this amount approximately \$100,000 has been paid and charged to earnings in the year ended December 31, 1978 and the balance will be paid and charged to earnings in the year ending December 31, 1979.

12. Anti-Inflation Legislation:

The Company has been subject to, and believes it has complied with, the controls on prices, profit margins, compensation and dividends under The Federal Government's Anti-Inflation Program which ended on December 31, 1978.

Reichhold Limited

10 Year Financial Review

(Thousands of dollars except per share items)

	1978	1977	1976
Sales	\$ 212,322	\$ 138,176	\$ 100,337
Earnings before income taxes	9,038	3,967	4,716
Net earnings	5,101	2,222	2,381
Expenditures on fixed assets	7,583	3,654	4,210
Investment in acquisitions	—	6,435	4,738
Provision for depreciation and amortization	2,439	2,063	1,660
Fixed assets at net book value	25,669	20,479	18,109
Basic earnings per common share ¹	\$ 2.53	\$ 1.39	\$ 1.49
Fully diluted earnings per common share ²	\$ 1.60	\$ 1.12	\$ 1.29
Fully diluted cash flow per common share ^{2 AND 3}	\$ 3.11	\$ 2.66	\$ 2.58
Dividends paid per common share ¹	\$.38	\$.34	\$.33
Book value per common share ^{1 AND 4}	\$ 11.81	\$ 10.27	\$ 9.81

¹Calculation of basic earnings per common share is based on the weighted monthly average number of shares outstanding during the respective periods. Book value per common share is based on the number of shares outstanding at the end of the respective periods. The number of common shares and per share calculations have been adjusted where applicable to reflect the stock split in August 1977 (3 for 1) and the stock split in December 1968 (3 for 1).

²Calculation of full dilution is after giving effect to the factors described in note 6(b) to the consolidated financial statements.

³Cash flow is represented by additions to working capital from operations.

⁴After deduction for redemption value of preference shares.

1975	1974	1973	1972	1971	1970	1969
\$ 82,733	\$ 76,860	\$ 36,972	\$ 27,252	\$ 24,203	\$ 21,762	\$ 21,202
4,623	8,210	2,930	1,826	1,046	327	319
2,375	4,218	1,632	981	512	145	217
4,671	2,795	2,316	1,074	677	742	979
—	—	8,056	—	—	—	—
1,214	1,148	762	635	579	525	632
12,970	9,346	7,469	5,014	4,524	4,401	4,175
\$ 1.49	\$ 2.65	\$ 1.13	\$.68	\$.35	\$.10	\$.15
\$ 1.29	\$ 2.26	\$.97	\$.59	\$.32	\$.08	\$.12
\$ 2.39	\$ 3.13	\$ 1.49	\$ 1.00	\$.68	\$.47	\$.51
\$.32	\$.24	\$.14	\$.10	\$.08	\$.08	\$.08
\$ 8.65	\$ 7.48	\$ 5.07	\$ 3.98	\$ 3.40	\$ 3.13	\$ 3.10

Valuation Day

For Canadian capital gains tax purposes, the Valuation Day value of Reichhold Limited securities on December 22, 1971 as established by the Department of National Revenue were the following:

Debentures:

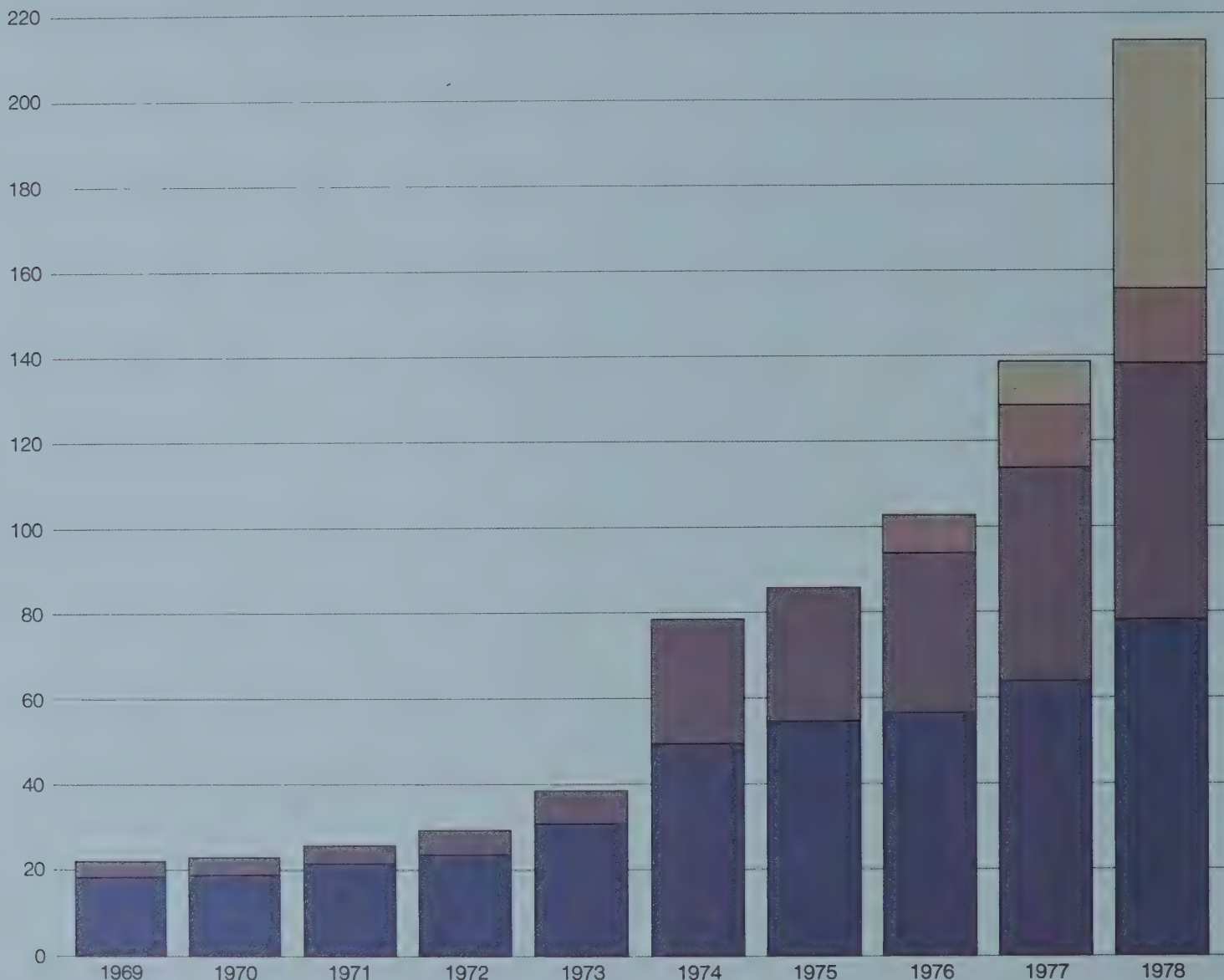
8-1/2% Series A.
due November 1, 1989 \$100.00

*Common shares: \$ 3.00

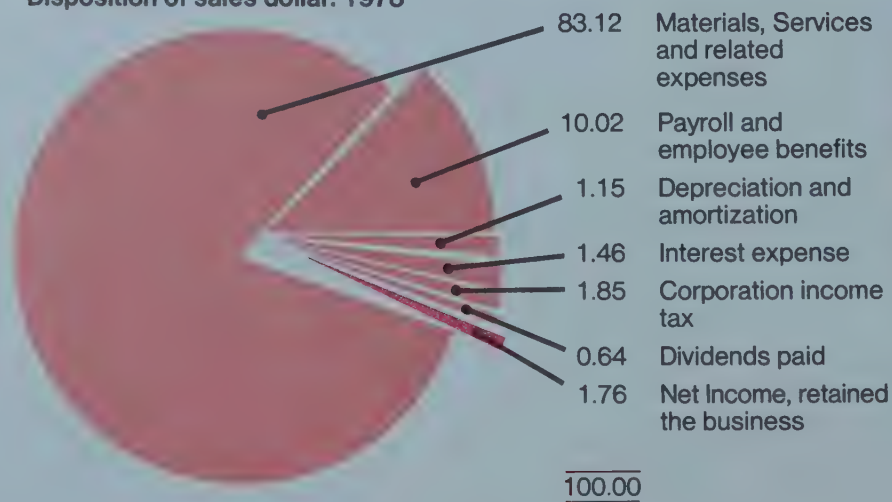
*The Valuation Day value of a common share has been adjusted to reflect the stock split in August 1977, whereby two additional shares were issued for each share held prior to the split.

10 Years of Sales Growth

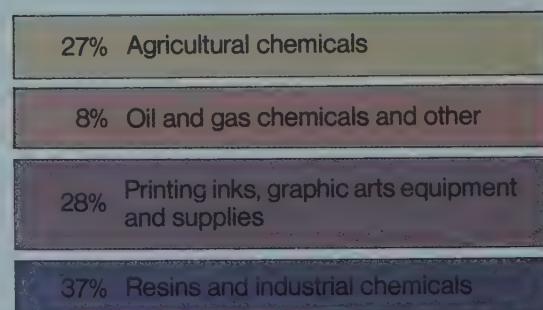
Millions of Dollars



Disposition of sales dollar: 1978



Dollar sales product mix: 1978



Growth through acquisition



Growth through acquisition has been one of the most important elements in the successful planned growth of Reichhold Limited.

The printing and graphic arts division which makes up about thirty percent of total sales was the first major diversification step. Canada Printing Ink was acquired in 1968, to be joined in late 1973 by the important marketing organization of Sears.

The graphic arts division illustrates how growth through acquisition is generated internally. This is a result of policies which make each division autonomous yet able to call on the facilities and resources of the total Reichhold organization when opportunities appear.

The Sears national sales organization in 1977 became the exclusive Canadian distributor of Itek printing supplies and equipment. This business has expanded considerably since, and is expected to grow strongly because of the special market it serves — companies which are not in the printing business but have their own in-plant printing facilities. In-plant printing is one of the fastest growing areas in the printing industry.

Canada Printing Ink, late in 1978, purchased the business of a printing ink subsidiary of a large publishing house. This resulted in a long-term contract to supply ink to that company.

Acquisitions generated within the individual divisions often are a reflection of an industry in the process of rationalization whereby smaller units come together into larger, more efficient and financially stronger businesses.

Large acquisitions in new fields most often result from the efforts of the management team and its business development group. Reichhold has designated one individual to pursue and explore for such acquisitions and major development projects on a continuing basis while working closely with division managers.

The agricultural chemicals division is an example of how a new field of business is entered and quickly developed by the combined efforts and substantial financial resources of the total organization.

Woolfolk Chemical Works Inc. was acquired in August 1977 to be followed by Niagara Chemical in October of that year. Woolfolk carried Reichhold into the United States in a major way. Woolfolk plans to expand vigorously in its market area and to push outwards into new areas where possible. A very substantial growth target has been set for this relatively-recent venture.

Niagara Chemical serves the Canadian market with agricultural chemicals and equipment. In its' most recent year, this division achieved record sales.

What's ahead? A continual search for opportunities. These could include acquisition of established businesses in growing industries and more intensive use of Reichhold's national marketing organization by introducing in Canada new products made outside Canada.

Growth from within



A major spur to Reichhold's business growth is the development and marketing success in the Company's established lines of business.

Capital expansion programs, research and development, and aggressive new business development have the possibility of rapid growth.

Virtually every activity in the Company has expanded its business base by building larger production facilities, by introducing new products, by expanding distribution and service and sales forces.

The Resin production group makes up the largest single segment of Reichhold's business. This group has major plant expansions underway. At Thunder Bay, Ontario, a resin production facility is being completed to supply spray-dry resins for use in manufacture of waferboard by the area's forest products industry.

At North Bay, Ontario a major expansion in the formaldehyde production facilities has just been completed and expansion of resin production facilities is underway.

In Kamloops British Columbia expansion of the resin production plant is now operational. This plant produces phenol-formaldehyde resin for the plywood industry.

At the Weston, Ontario plant plans are well underway for the expansion of alkyd resin and polyester resin facilities.

The Graphic Arts group continued to achieve an outstanding performance with sales in 1978 rising over 20%.

Canada Printing Ink's new newsprint and web offset ink plant at Burlington, Ontario is now on stream. The plant was designed to serve its enlarged markets which have been further enhanced through the acquisition of the ink subsidiary of a Quebec-based publishing company. The knowledge and skills of Canada Printing Ink are finding markets in other countries where its technology is being licensed. Prospects for expanded business in the United States are excellent.

The Sears and Itek divisions continued to grow rapidly, extending and upgrading the product lines offered to the Canadian printing market. In 1978, distribution rights were obtained for Canada of printing equipment manufactured by MBO and Olivetti. These are two important additions to the line of printing products which Sears distributes and services across Canada.

The agricultural chemicals business created by the acquisition of Niagara Chemical in Canada and Woolfolk Chemical in the U.S.A. had a successful initial full 12-month period as part of Reichhold. Sales of over \$56 million were achieved, making this a very important part of Reichhold's total business.

Agricultural Chemicals present many opportunities for accelerated growth by expanding distribution and service networks in Canada and the U.S. These chemicals and specialized equipment are vital to efficient and healthy growth of food crops.

Woolfolk presents a special opportunity in retail distribution of its own products as well as products of other manufacturers. In total some 375 different products are sold through 3,500 U.S. retailers. A specific area of growth is the extension of the sale of home and garden chemicals to other regions.

Sales of chemicals for the oil and gas industry rose substantially in 1978. The Intertech distribution business had a very satisfactory year, its first full year as a nationwide Reichhold distribution facility.

In the background, a series of research and development projects in various stages present further opportunities for growth.

The Company has been granted new patents on its phenolic resins. This should have real significance for our business in both domestic and foreign markets.

Internal expansion can be illustrated by the growth in capital expenditures. For 1976 and 1977, expansion and improvement of plant required investment of some \$7.9 million. For 1978 alone, capital expansion programs totalled \$ 7.6 million. Capital expenditures already projected for the next five years total almost \$ 40 million.

The goal now is to use the vastly-broadened business base, and the special knowledge contained in the Reichhold organization to improve efficiency, increase profitability and develop new sources of income.

REICHHOLD





REICHHOLD



DIRECTORS

Robert J. Adams

Vice-President and Manager,
Resin Division – Eastern

Charles B. Breedlove

Executive Vice-President
Reichhold Chemicals Inc.

Alexander B. Davie

Vice-President and Manager,
Resin Division – Western

Peter J. Fass

President
Reichhold Chemicals, Inc.

George L. Hagen

President and Chief Executive Officer
Reichhold Limited

Donald J. McLeod

Vice-President and Manager,
Resin Division – Central

Donald G. McNabb

Executive Vice-President
Reichhold Limited

William H. Munden

Vice-President and General Manager
Canada Printing Ink Division

Robert T. O'Shaughnessy

Vice-President, Administration
Reichhold Limited

David Phillips

Vice-President, Finance
Sears Division

William H. Sears

Vice-President and General Manager
Sears Division

Brian W. Shields, Q.C.

Partner, Law Firm of Tory, Tory
DesLauriers and Binnington

OFFICERS

G.L. Hagen

Chairman of the Board, President and
Chief Executive Officer

D.G. McNabb

Executive Vice-President

R.J. Adams

Vice-President

A.B. Davie

Vice-President

J. Demicher

Chief Financial Officer and Treasurer

D.J. McLeod

Vice-President

W.H. Munden

Vice-President

R.T. O'Shaughnessy

Vice-President

T.I. Paul

Corporate Comptroller

W.H. Sears

Vice-President

B.W. Shields, Q.C.

Secretary

R.F. Smith

Vice-President and General manager
Travis Chemicals Division

H.H. Reichhold

Honorary Chairman of the Board

PLANTS & OFFICES

Head Office

600 The East Mall
Islington (Toronto), Ontario
M9B 4B1

RESIN AND CHEMICALS GROUP

Resin Division

Weston, Ontario
Ste. Therese de Blainville, Quebec
Lindsay, Ontario
North Bay, Ontario
Thunder Bay, Ontario
Kamloops, British Columbia
Port Moody, British Columbia

Travis Chemicals Division

Calgary, Alberta
Edmonton, Alberta
Fort St. John, British Columbia

Molsberry Division

Edmonton, Alberta
Calgary, Alberta
Peterborough, Ontario

Intertech Division

Richmond, British Columbia
Calgary, Alberta
Winnipeg, Manitoba
Toronto, Ontario
Boucherville, Quebec
Dartmouth, Nova Scotia

Niagara Chemical Division

Burlington, Ontario
Longueuil, Quebec
Regina, Saskatchewan
Kelowna, British Columbia

GRAPHIC ARTS GROUP

Canada Printing Ink Division

Halifax, Nova Scotia
Moncton, New Brunswick
Quebec City, Quebec
Montreal, Quebec
Ottawa, Ontario
Toronto, Ontario
Burlington, Ontario
London, Ontario
Winnipeg, Manitoba
Edmonton, Alberta
Calgary, Alberta
Vancouver, British Columbia

Sears Division

Moncton, New Brunswick
Quebec City, Quebec
Montreal, Quebec
Ottawa, Ontario
Toronto, Ontario
Hamilton, Ontario
Kitchener, Ontario
London, Ontario
Winnipeg, Manitoba
Saskatoon, Saskatchewan
Edmonton, Alberta
Calgary, Alberta
Vancouver, British Columbia

PRINCIPAL OPERATING SUBSIDIARY

Woolfolk Chemical Works, Inc.

Fort Valley, Georgia

Registrar and Transfer Agent Common Stock

National Trust Company, Limited
Toronto, Montreal, Vancouver,
Calgary, Winnipeg

Auditors

Peat, Marwick, Mitchell & Co.
Commercial Court West
Toronto

Mauldin & Jenkins
Albany, Georgia

*Printed on a Heidelberg 72V Speedmaster 4 colour 20" x 28" offset press
using Canada Printing Ink process inks and U. V. Wetlock cover coating*

LITHOGRAPHED IN CANADA.

REICHHOLD

Reichhold Limited
600 The East Mall
Islington, Ontario,
M9B 4B1

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REICHHOLD

Reichhold Limited

Shareholders' Report

**For the six months
ended June 30, 1978**

REICHHOLD

Reichhold Limited
600 The East Mall
Islington, Ontario
M9B 4B1

To Our Shareholders

Reichhold's earnings of \$2,512,000 in the first half of 1978 were the best in its history. Second quarter earnings also set a new record.

Second quarter net earnings were \$1,712,000 or 94 cents per share after deducting preference share dividends. This compares with \$417,000 or 26 cents per share for the same period last year. This significant improvement came from higher sales and the contribution of new operations. The Resin Division had a particularly strong 2nd quarter due in large measure to improved plant utilization.

Total sales were \$64,089,000 in the 2nd quarter, an increase of 91% compared with last year. This brought sales for the first half year to \$107,098,000 versus \$63,486,000 last year.

We are very pleased with the results from the newly acquired agricultural chemical businesses, both in Canada and the United States.

An increase in the dividend on common shares was approved for shareholders of record as of August 9. The new dividend rate will be 10 cents quarterly, an 11% increase. This increase is in recognition of the stronger earnings and in line with the Company's policy to improve dividends as profits permit.

The last half of the year should be very good but with somewhat lower earnings than the first half due to the seasonal nature of some of our businesses.

George L. Hagen
President

July 31, 1978

A Nos Actionnaires

Les bénéfices de \$2,512,000 réalisés par Reichhold au premier semestre de 1978, sont les plus élevés à date. Les bénéfices du deuxième trimestre ont aussi atteint un sommet sans précédent.

Les bénéfices nets du deuxième trimestre furent de \$1,712,000 ou de 94 cents par action après déduction des dividendes sur les actions privilégiées. Ce chiffre se compare à \$417,000 ou à 26 cents par action pour la même période l'an dernier. Cette amélioration marquée provient de ventes plus nombreuses et de la contribution des nouvelles opérations. La Division de résine a réussi un deuxième trimestre particulièrement favorable attribuable en grande partie à l'utilisation d'une usine mieux aménagée.

Le total des ventes s'est élevé à \$64,089,000 au cours du deuxième trimestre, soit une augmentation de 91% en comparaison de l'an dernier. Ce chiffre a porté les ventes pour le premier semestre à \$107,098,000 en comparaison de \$63,486,000 l'an dernier.

Nous sommes très heureux des résultats provenant des entreprises de produits chimiques agricoles récemment acquises, au Canada et aux Etats-Unis.

Une augmentation du dividende sur les actions ordinaires fut approuvée pour les actionnaires inscrits aux registres le 9 août. Le nouveau taux de dividende sera de 10 cents par trimestre soit une augmentation de 11%. Cette augmentation est en considération des bénéfices favorables et correspond à la politique de la compagnie d'augmenter les dividendes lorsque les profits le permettent.

Le dernier semestre de l'année devrait s'avérer très favorable mais avec des bénéfices un peu moins élevés qu'au cours du premier semestre à cause de la nature saisonnière de certains secteurs de nos affaires.

George L. Hagen
Le président

Le 31 juillet 1978

INTERIM STATEMENT OF CHANGES IN FINANCIAL POSITION

For the Six Months Ended June 30, 1978 and 1977

[Subject to Year-end Audit and Adjustment]	Second Quarter	SIX MONTHS	
	1978	1978	1977
	[Thousands of Dollars]		
Additions to Working Capital			
Net Earnings	\$ 1,712	\$ 2,512	\$ 790
Depreciation and Amortization	592	1,163	1,150
Exercise of Share Purchase Warrants	—	12	29
Increase in Deferred Income Tax	1,052	1,535	352
	<u>\$ 3,356</u>	<u>\$ 5,222</u>	<u>\$ 2,321</u>
Deductions from Working Capital			
Net Additions to Fixed Assets and Land	\$ 2,831	\$ 3,696	\$ 2,213
Increase in Lien Notes Receivable	514	808	1,475
Reduction of Long Term Debt	—	—	786
Dividends	322	693	266
Increase in Deferred Charges	—	—	26
	<u>\$ 3,667</u>	<u>\$ 5,197</u>	<u>\$ 4,766</u>
Increase/(Decrease) in Working Capital	(\$ 311)	\$ 25	(\$ 2,445)
Working Capital Beginning of Year	<u>\$19,465</u>	<u>\$19,129</u>	<u>\$12,565</u>
Working Capital End of Period	<u>\$19,154</u>	<u>\$19,154</u>	<u>\$10,120</u>
Additional Balance Sheet Information			
Net Property, Plant and Equipment		<u>\$23,073</u>	\$19,281
Long Term Debt		<u>\$13,620</u>	\$13,340
Deferred Income Taxes		<u>\$ 5,867</u>	\$ 4,124
Shareholder's Equity		<u>\$28,498</u>	\$16,194

CONSOLIDATED STATEMENT OF EARNINGS

For the Six Months Ended June 30, 1978 and 1977

[Subject to Year-end Audit and Adjustment]	Second Quarter	SIX MONTHS	
	1978	1978	1977
	[Thousands of Dollars]		
Net Sales	\$64,089	<u>\$107,098</u>	\$63,486
Cost of Sales	<u>51,727</u>	<u>85,492</u>	50,490
Gross Profit	\$12,362	<u>\$ 21,606</u>	\$12,996
Selling, General and Administrative Expenses	8,434	<u>15,629</u>	10,316
Net Operating Profit	\$ 3,928	<u>\$ 5,977</u>	\$ 2,680
Interest (Net)	771	<u>1,425</u>	1,083
Earnings Before Income Taxes	\$ 3,157	<u>\$ 4,552</u>	\$ 1,597
Estimated Income Taxes — Current	393	<u>490</u>	455
— Deferred	1,052	<u>1,550</u>	351
Net Earnings	<u>\$ 1,712</u>	<u>\$ 2,512</u>	<u>\$ 791</u>
Earnings per share (average shares outstanding in 1978, 1,641,366 in 1977 1,601,772) after deducting \$398,687 for preference share dividend in			
1978 only	\$.94	<u>\$ 1.29</u>	\$.49
Fully Diluted Earnings per Share	<u>\$.54</u>	<u>\$.79</u>	<u>\$.43</u>